

TESTIMONY OF DR. ROBERT W. CRANDALL

QUALIFICATIONS

1. My name is Robert W. Crandall. I am the chairman of Criterion Economics and have been a Senior Fellow in Economic Studies at the Brookings Institution since 1978. Prior to that I was the Acting Director, Deputy Director, and Assistant Director of the Council of Wage and Price Stability in the Executive Office of the President, and between 1974 and 1975 I was an Adviser to Commissioner Glen Robinson of the Federal Communications Commission. I was an Assistant Professor and Associate Professor of Economics at MIT between 1966 and 1974.

2. I have written widely on telecommunications policy, the economics of broadcasting, and the economics of cable television. In 1971 and 1972, I published articles on the FCC financial-interest/syndication rules in *The Journal of Law and Economics* and the *Bell Journal of Economics*. In 1974, I coauthored an article on cable television profitability in *The Journal of Business*. In 1974, I also published an article on the economics of network television in *Public Policy*. In 1978, I published an article on the economic effect of television broadcast regulation in *Regulation*. In 1981, Stanley Besen and I coauthored a paper on cable television regulation that was published in *Law and Contemporary Problems*. In 1990, I conducted a number of empirical studies of the cable television industry that were submitted in various FCC proceedings on behalf of TCI and are incorporated into a chapter in Bruce Owen and Steven

Wildman's *Video Economics*, published by Harvard University Press in 1992. I am the co-author of two books released in 1996 by the Brookings Institution: *Talk is Cheap: The Promise of Regulatory Reform in North American Telecommunications* (with Professor Leonard Waverman) and *Cable TV: Regulation or Competition?* (with former FCC Commissioner Harold Furchtgott-Roth).

3. I have served as a consultant to several government agencies and participated in a variety of government advisory panels. Between 1967 and 1968, I was a consultant to the Justice Department on a variety of network television and motion picture issues. Between 1978 and 1979, I served as a consultant to the Federal Communications Commission (FCC) on the deregulation of signal carriage rules for cable television. I have also served a consultant to several clients on matters relating to copyright and product licensing issues—including the National Cable Television Association, the three major television broadcast networks, and other cable and broadcast industry clients.

4. I testified before the Copyright Royalty Tribunal on behalf of the Joint Sports Claimants ("JSC") in the 1989 cable royalty distribution proceeding and on behalf of the National Cable Television Association in the 1981 proceeding to adjust cable royalty rates. I also testified before the Copyright Arbitration Royalty Panel on behalf of JSC in the 1990-92 cable royalty distribution proceeding.

5. I am offering this testimony on behalf of JSC in my individual capacity and not as employee of the Brookings Institution, which does not take institutional positions with respect to specific legislation, litigation, or regulatory proceedings.

6. A copy of my curriculum vitae is attached.

INTRODUCTION

7. In 1976, Congress created a compulsory license system that allows cable system operators to retransmit broadcast television signals without negotiating an agreement with the copyright holders for individual programs on those television signals. In return for the compulsory license, cable systems that retransmit any broadcast signals pay into one or more copyright royalty funds maintained by the U.S. Copyright Office. Owners of the rights to the non-network programming that is retransmitted on a distant signal basis on cable systems are entitled to claim the royalty funds. If all of the claimants to the royalty funds cannot agree on the distribution of these funds, disputes are resolved by a Copyright Arbitration Royalty Panel ("CARP", or "the Panel") appointed by the Copyright Office. Before the arbitration panel system was created, royalty claim disputes were resolved by a permanent Copyright Royalty Tribunal ("CRT").

8. At the time the compulsory license was instituted in 1976, the FCC restricted the number of distant signals that a cable system could carry. The FCC also subjected programming on distant signals to blackout if a local broadcaster had purchased exclusive rights to that programming. The FCC lifted these two restrictions in 1980, and in 1982, the CRT instituted two new cable royalty funds in addition to the "Basic Fund" to compensate copyright holders for the removal of these restrictions: the "3.75% Fund" and the "Syndex Fund." The Basic Fund consists of all royalties paid by "Form 1" and "Form 2" systems (those with less than \$292,000 in semi-annual gross receipts), plus the royalties paid by "Form 3" cable systems for carriage of distant signals that would have been permitted under the FCC's pre-1980 distant signal carriage rules. The 3.75% Fund consists of royalties paid by Form 3 systems for carriage of each distant signal that would not have been allowed under the FCC's former distant-signal carriage restrictions.

Cable systems pay into the Syndex Fund where they retransmit distant signal programming that would have been subject to blackout under the FCC's old syndicated exclusivity rules. Currently, only the Program Suppliers and Music Claimants receive proceeds from the Syndex Fund, which consists of less than \$100,000 per year.

9. Since Congress instituted the compulsory license, the CRT and CARP have presided over six "Phase I" disputes among the different classes of royalty claimants. In the last Phase I royalty distribution (involving the 1990, 1991 and 1992 funds), the three-member CARP reached a divided decision on, among other things, the JSC award. The CARP majority allocated JSC 29.5 percent of the Basic Fund and 32.6 percent of the 3.75% Fund. The third CARP member concluded that JSC should have received a larger share of each fund—30.5 percent of the Basic Fund and 38.5 percent of the 3.75% Fund. Table 1 displays the CARP's allocation of the Basic and 3.75% Funds in the 1990-92 proceeding.

TABLE 1: 1990-92 CARP ROYALTY AWARDS;
MAJORITY AND DISSENT

Claimant	Majority's Award*		Dissent's Award*	
	(%)		(%)	
	Basic	3.75%	Basic	3.75%
JSC	29.50	32.60	30.50	38.50
Program Suppliers	55.00	58.60	50.20	48.80
Commercial TV (NAB)	7.50	7.50	9.50	9.50
Public TV (PBS)	5.75	-	5.80	0.00
Devotionals	1.25	0.95	3.00	3.00
Canadians	1.00	0.35	1.00	0.20

*Note that the above numbers represent the CARP's allocation of the 1991 and 1992 royalties. The CARP's allocation of the 1990 royalties was only slightly different to account for the fact that the Canadian Claimants had settled for that year but not 1991-92. In addition, note that the Register of Copyrights reduced the final award to each of the above claimant group proportionately to account for settlements with other Phase I Claimants. The Librarian also slightly increased the JSC and Program Supplier shares, and decreased the Canadian share, of the 1991 and 1992 3.75% Funds to account for the fact that there is JSC and Program Supplier programming on Canadian signals. See Appendix A, showing the Librarian allocations.

Source: CARP Report on Cable Royalties for the Years 1990-92 at 143, 174-175 (May 31, 1996) [hereinafter CARP Report].

10. The CARP in the 1990-92 proceeding started by attempting to replicate the relative value that a market would assign each claimant's programming.¹ In conducting that exercise, the CARP majority considered the survey of cable system operators undertaken by Bortz Media and Sports Group (the "Bortz survey") to be "highly valuable in determining market value."² Nevertheless, the CARP majority's award to JSC (approximately 30 percent before the Register's adjustments) was between six and nine percentage points less than the shares reflected in the Bortz surveys for JSC programming. That disparity amounted to between \$30 and \$45 million for the years 1990-92. As reflected in Table 2 below, no other claimant group received an award in the 1990-92 proceeding that reflected such a substantial dollar reduction from its share in the Bortz surveys.

TABLE 2: COMPARISON OF 1990-92 CARP MAJORITY ROYALTY AWARDS
AND 1990-92 CABLE OPERATOR SURVEY RESULTS

Claimant	Weighted Average* Award (%)	Cable Operator Survey Share (%)	Revenue (Shortfall)/Surplus (\$ Million)
JSC	30.3	36.3 – 38.8	(\$31.2 – \$44.1)
Program Suppliers	56.0		\$49.9 – \$80.8
Movies		25.6 – 30.1	
Series		14.5 – 16.0	
Commercial TV (NAB)	7.5	11.9 – 14.8	(\$22.6 – \$37.6)
Public TV (PBS)	4.2	2.7 – 3.0	\$7.0 – \$ 8.5
Devotionals	1.2	3.6 – 4.3	(\$12.5 – \$16.1)
Canadians	0.8	0.0 – 0.5	\$1.8 – \$4.3

Source: CARP Report at 50, 143; 61 Fed. Reg. 55655, 55662; Copyright Office Reports of Receipts.

Note: The weighted average award is calculated by using revenue weights for each claimant's Basic and 3.75 Fund awards.

11. I have been asked by JSC to consider whether the CARP in the 1990-92 proceeding had an economically sound basis for awarding JSC significantly less than JSC's share in the Bortz surveys. For the reasons set forth below, I do not believe that there was such a

1. CARP Report at 23-25.

basis. In my opinion, the award to JSC should not have been less than the royalty share reflected in the Bortz surveys.

I. THE CARP SHOULD CONTINUE TO ALLOCATE THE CABLE ROYALTY FUNDS CONSISTENTLY WITH HOW THEY WOULD HAVE BEEN ALLOCATED IN A MARKET

12. Typically, a copyright holder of non-network programming on a broadcast station is directly compensated by that station. The broadcast station pays the copyright holder from the station's advertising revenues. When a cable system carries a "distant" broadcast station, the programming on that station is available to a larger audience than otherwise. A distant broadcast station, in general, is a station that is not located in the cable system's television market and whose carriage was not mandated under the FCC's 1976 or current "must carry" rules. Large transaction costs would make it difficult for cable systems to compensate the copyright holders of the many programs on these distant signals for the use of their programming.

13. Congress established compulsory licensing as a substitute for arms-length transactions between cable systems and individual copyright holders of distant-signal programming. These fees are distributed to the copyright owners whose non-network programming has been retransmitted on distant broadcast signals. Congress intended the compulsory license to be a more efficient way of compensating copyright owners by eliminating the transaction costs that would result from direct negotiations between cable systems and all of the copyright owners of programming retransmitted on distant signals.

2. *Id.* at 66.

14. In previous Phase I disputes, the CRT and CARP have decided that the allocation of royalties must be based on how copyright holders would have been compensated in a market environment. Although the “market” valuation standard has been constant, there have been some differences in how past distribution decisions have described the hypothetical market. The CRT’s decision regarding the 1989 cable royalty distribution suggests a market in which cable system operators would buy programming from the copyright holders. The court of appeals took a similar view: that Congress intended the CRT (now CARP) to “operate as a substitute for direct negotiations . . . among cable operators and copyright owners.”³ The CARP’s decision regarding the 1990-92 cable royalty distribution describes a marketplace in which cable operators would buy programming from the distant signal broadcasters rather than directly from the copyright holders.⁴

15. From an economic perspective, using a market valuation approach is the appropriate way to determine the royalty shares that should be awarded to each of the claimants. The compulsory license process was not designed to deprive the copyright owners of their relative shares of the market value of the imported programming. Moreover, because the issue that the CARP confronts is the relative valuation of different programming types, rather than the valuation of different distant signals as a whole, the CRT’s formulation of the hypothetical market (one in which cable operators purchase programming directly from copyright holders) is more relevant.

16. In a competitive environment, a market transaction under either the CRT or the CARP’s formulation would compensate a copyright holder according to the copyrighted

3. *Christian Broadcasting Network v. CRT*, 720 F.2d at 1306.

program's *marginal* contribution to cable-system net revenues. In other words, the cable operator would be willing to buy rights to the programming directly or indirectly from the copyright holder according to how much additional revenue the cable operator would generate by retransmitting the copyrighted programming.

17. Determining this "market value" for specific types of programming is difficult. The compulsory license requires the cable operator to pay the full six-month royalty even if only a single program is retransmitted over that period. Moreover, the cable operator may not insert commercials or otherwise modify the distant signal. As a result, it is almost impossible to determine the precise marginal contribution to a cable system of a specific copyright holder's programming on a distant signal. Therefore, one must look for other evidence to estimate a hypothetical market between copyright holders and cable system operators.

II. THE BORTZ SURVEY OF CABLE OPERATORS REPRESENTS THE BEST APPROXIMATION OF A MARKET TRANSACTION BETWEEN A CABLE SYSTEM OPERATOR AND CLASSES OF COPYRIGHT HOLDERS

18. As I have explained in my prior testimony before the CARP, the best evidence of valuation of any specific programming type is the data provided by the Bortz survey. The survey aggregates opinions of cable operators who have chosen to retransmit programming and thus would have been the "buyers" in the hypothetical distant signal marketplace the CARP seeks to recreate. In past CRT and CARP proceedings, a variety of witnesses for JSC and other claimants, including NAB and PBS, have endorsed the Bortz methodology.⁵ The cable system operators

4. See CARP Report at 23-24.

5. The 1989 CRT and 1990-92 CARP reports discuss the various witnesses who have supported the Bortz survey during those two proceedings. See CRT Report, 57 Fed. Reg. 15286 at 15292-95; and CARP Report at 45-

surveyed are responsible for knowing the demographics of their systems' markets and what types of programming will increase demand for subscriptions to these cable systems given their existing programming and subscriber bases. Therefore, these cable system operators should be able to make a reasonably accurate assessment of the value of a copyright holder's programming to their cable systems. From an economist's standpoint, sampling and aggregating the valuation opinions of buyers in the would-be marketplace provides a very robust model of how cable program budgets would have been spent in a market where programming on distant signals was being sold.

19. The Bortz data show that cable operators placed a very high value on sports programming in 1990-92 as well as 1998-99, a result that is not surprising. The sports programming of the JSC is unique in that it is live, first-run programming. Live sporting events lose most of their value immediately after they are first transmitted. A viewer has many opportunities to watch other types of programming, but he only has one opportunity to watch a live sporting event. In addition, sports fans are intensely loyal and identify personally with sports teams. Distant signals also provide a *new* source of live sports programming for viewers, whereas viewers can often see other programs on both the distant signals and on other local broadcast stations or cable networks. Cable system operators do not need distant signals for this

54. The witnesses include Paul I. Bortz (1989; 1990-92; testifying for JSC); market researcher Dr. Joel Axelrod (1990-92; testifying for JSC); University of Georgia economist Dr. Leonard Reid (1989; testifying for JSC); market researcher Dr. Samuel Book (1989; testifying for JSC); Northwestern University economist Dr. Stephen Wildman (1990-92; testifying for NAB); Vanderbilt University economist Dr. David Scheffman (1990-92 testifying for PBS); Boston University economist Dr. Michael Sallinger (1990-92; testifying for Devotionals); Statistician Dr. William Fairley (1990-92; testifying for PBS); Cable executive Dr. David Clark (1990-92 ; testifying for Devotionals); NAB Vice President of Research Dr. Richard Ducey (1990-92; testifying for NAB); PBS Research Director John Fuller (1990-92; testifying for PBS); valuation expert Paul Much (1990-92; testifying for NAB).

duplicate programming; it will not have the effect on subscription revenues that live sporting events have.

**III. ALTHOUGH THE 1990-92 CARP RELIED ON THE BORTZ SURVEY TO SIMULATE AN
EFFICIENT ALLOCATION OF THE ROYALTY FUNDS,
IT UNDERVALUED SPORTS PROGRAMMING**

20. As noted above, the 1990-92 CARP was split with two arbitrators issuing a majority report and the third arbitrator dissenting. The majority report found the Bortz data to be “highly valuable” but awarded the Joint Sports Claimants roughly six to nine percentage points (depending on the year) less of the Basic Fund than the Bortz results suggested (see Tables 1 and 2). The majority report cited one primary criticism of the Bortz survey in deciding not to tie the awards more closely to the Bortz survey—namely, that Bortz only examined “attitudes” of cable system operators, and thereby failed to incorporate any “supply side” effects of copyright holders into its calculation. As I discuss briefly below, from an economic perspective, this criticism is without merit, and even if it were true, would not support a negative deviation from the Bortz data for JSC. The third arbitrator rejected this concern and supported a higher award for JSC that was more consistent with the Bortz analysis.

21. The Majority in the 1990-92 CARP criticized the Bortz survey because it measured “attitudes rather than conduct.”⁶ The Panel was correct that the survey does not attempt to measure actual conduct other than conduct and experience that is reflected in the estimations provided by the survey respondents. Because the compulsory license system obviates arms-length negotiations for distant-signal programming, the actual conduct never happens and accordingly cannot be surveyed. The Panel has recognized that, in addition to the Bortz survey,

there are marketplace decisions (for example, cable system payments for particular cable network programming) that may be relevant indicators of the relative value of the claimants' programming but which do not directly address the question that the Panel must resolve.

22. The claim that Bortz fails to incorporate the actual competitive interactions among cable operators and copyright holders is no different from the claim that Bortz fails to incorporate "supply side" effects. The Majority said that the relevant question was "what would the cable system operator have to and be willing to spend. While the operator may be willing to spend a certain amount of its budget for a given category of programming, the market supply may be at odds with what the operator is willing to spend."⁷ These two panelists did not further elaborate on what they meant by "supply side" considerations; nor did they explain why the "supply side" concern would affect JSC or any other particular claimant group more than another.

23. The panelists appear to suggest that the motivations of the seller might not be captured by the Bortz survey—that is, some claimant groups might demand more than what the cable operators were willing to spend and that others might demand less. I have carefully reviewed the 1990-92 CARP report and have found nothing in that report to suggest that JSC's likely motivations justified a reduction in JSC's royalty share as reflected in the Bortz survey. The panelists did not cite to, and I am not aware of, any evidence that JSC's relative willingness to supply programming would have resulted in a lower share of royalty revenues than was

6. *Id.* at 66.

7. *Id.*

reflected in the Bortz survey.⁸ Indeed, the dissenting opinion correctly rejected these arguments, explaining that the “careful structure of the compulsory license itself plays a significant role in helping to define the marketplace, including the supply side,” and likening the supply side of this marketplace to a “forced sale situation.”⁹ The dissenting opinion understood that copyright owners could not restrict supply in a but-for world in which cable system owners negotiated directly with copyright holders—hence, any supply side effects would be negated.

24. Even if copyright holders could restrict supply on distant signals, there is no evidence to suggest that cable system operators would spend more or less on sports programming than their Bortz share. Indeed, when it comes to negotiating with cable operators, sports programmers could be no “weaker” than broadcasters in securing a large share of expenditures. Broadcasters have demonstrated a greater interest in securing carriage on cable systems and making their programming available to as many cable system subscribers as possible at the lowest possible price. I am not aware of any similar evidence of JSC members. Accordingly, these supply side considerations would not support a similar reduction from the Bortz results for JSC programming.

8. There is a discussion of the JSC case in the CARP Report at 86-100 that does not explain why the “supply side” concern would cause a deviation from the Bortz results just for JSC. The only other studies considered by the CARP presented viewing data which, as I have explained in prior testimony, do not measure value.

9. See CARP Report at 172.

IV. THE 1990-92 MAJORITY CARP DECISION DID NOT JUSTIFY AN AWARD OF THE 3.75% FUND LOWER THAN THE AWARD SUGGESTED BY THE BORTZ SURVEY RESULTS

25. The Register of Copyrights noted that the 1990-92 CARP's discussion of its allocation of the 3.75% Fund was "at best, terse."¹⁰ Even after consulting further with the Panel regarding its 3.75% Fund award to JSC, the Register found the Panel's reasoning "troublesome."¹¹ It appears that the Panel simply applied its Basic Fund award allocations to the 3.75% Fund after accounting for those claimants who had no programming that generated 3.75% Fund payments. As a result, the shortcomings in the Panel's Basic Fund award to JSC which I have discussed above are also reflected in the 3.75% Fund award to JSC. In neither instance does the Panel articulate a reason for its downward departure from the value ascribed to JSC programming by the Bortz survey.

26. Moreover, the Panel apparently did not address the fact that the mix of distant signals generating payments to the 3.75% Fund was different than the mix of distant signals generating Basic Fund payments. I understand that JSC contended in 1990-92 that the 3.75% Fund distant signals were more heavily weighted towards signals carrying JSC programming than were the Basic Fund signals. If that were the case, I would expect that the JSC award would have been proportionally higher with respect to the 3.75% Fund.


CONCLUSION

27. The CARP should continue to allocate the cable royalty funds by attempting to simulate free-market transactions between copyright holders of distant-signal programming and cable system operators. The Bortz survey is the best tool available to simulate these transactions..

10. 61 Fed. Reg. at 55662 (Oct. 28, 1996).

The CARP should recognize that any limitations of the survey do not negatively affect the JSC more than any other claimant. In previous decisions, the CRT and CARP have not justified their reluctance to award the JSC the share of the royalty funds implied by the Bortz survey results. The CARP should award JSC shares of the Basic and 3.75% Funds that are no lower than the Bortz survey results.

I declare under penalty of perjury that the foregoing is true and correct to the best of my knowledge and belief. Executed at Washington, D.C. on this 29th day of November, 2002



Robert W. Crandall

11. *Id.*

CRITERION ECONOMICS, L.L.C.

APPENDIX A: THE LIBRARIAN'S ALLOCATIONS

<i>1990</i>	<i>Basic Fund</i>	<i>3.75% Fund</i>
Program Suppliers	52.633625%	56.0125439%
JSC	28.235500%	31.1605620%
NAB	7.182050%	7.1688409%
Music Claimants	4.500000%	4.5000000%
PBS	5.504975%	-
Devotional Claimants	1.193850%	0.9080532%
Canadian Claimants	0.750000%	0.2500000%

<i>1991-1992</i>	<i>Basic</i>	<i>3.75 Percent</i>
Program Suppliers	52.52500%	56.0131375%
JSC	28.17250%	31.2299325%
NAB	7.16250%	7.1625000%
Music Claimants	4.50000%	4.5000000%
PBS	5.49125%	-
Devotional Claimants	1.19375%	0.9072500%
Canadian Claimants	0.95500%	0.1871800%

Source: 61 Fed. Reg. 55669.

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Should We Regulate Broadband? (edited with James Alleman), AEI Brookings Joint Center for Regulatory Studies, 2002, forthcoming.

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Certificate of Service

I hereby certify that on Monday, February 12, 2018 I provided a true and correct copy of the Robert Crandall Written Direct Testimony (JSC Written Direct Statement Vol. II) to the following:

Public Broadcasting Service (PBS), represented by Lindsey L. Tonsager served via Electronic Service at ltonsager@cov.com

National Association of Broadcasters (NAB), represented by John Stewart served via Electronic Service at jstewart@crowell.com

Broadcast Music, Inc. (BMI), represented by Joseph DiMona served via Electronic Service at jdimona@bmi.com

SESAC, Inc., represented by John C. Beiter served via Electronic Service at jbeiter@lsglegal.com

MPAA-represented Program Suppliers, represented by Lucy H Plovnick served via Electronic Service at lhp@msk.com

Devotional Claimants, represented by Benjamin S Sternberg served via Electronic Service at ben@lutzker.com

Spanish Language Producers, represented by Brian D Boydston served via Electronic Service at brianb@ix.netcom.com

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National Public Radio, Inc. (NPR), represented by Gregory A Lewis served via Electronic Service at glewis@npr.org

American Society of Composers, Authors and Publishers (ASCAP), represented by Sam Mosenkis served via Electronic Service at smosenkis@ascap.com

Multigroup Claimants, represented by Brian D Boydston served via Electronic Service at brianb@ix.netcom.com

Signed: /s/ Michael E Kientzle